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Supreme Court of the United States

No. 591

TERM A. D. 1944.

IN THE MATTER

OF

ASSOCIATED GAS AND ELECTRIC COMPANY,
Debtor,

In Proceedings for the Reorganization of a Corporation Pursuant to Chapter X of the Bankruptcy Act.

THATCHER C. JONES, FREDERICK T. SUTTON and RUSSELL M. VAN KIRK, constituting the Scrip Holders Protective Committee of ASSOCIATED GAS AND ELECTRIC COMPANY,
Petitioners and Appellants Below,

AGAINST

STANLEY CLARKE, Trustee of ASSOCIATED GAS AND ELECTRIC COMPANY, Debtor, *et al.*,
Respondents and Appellees Below.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals, for the Second Circuit, and Brief in Support Thereof.

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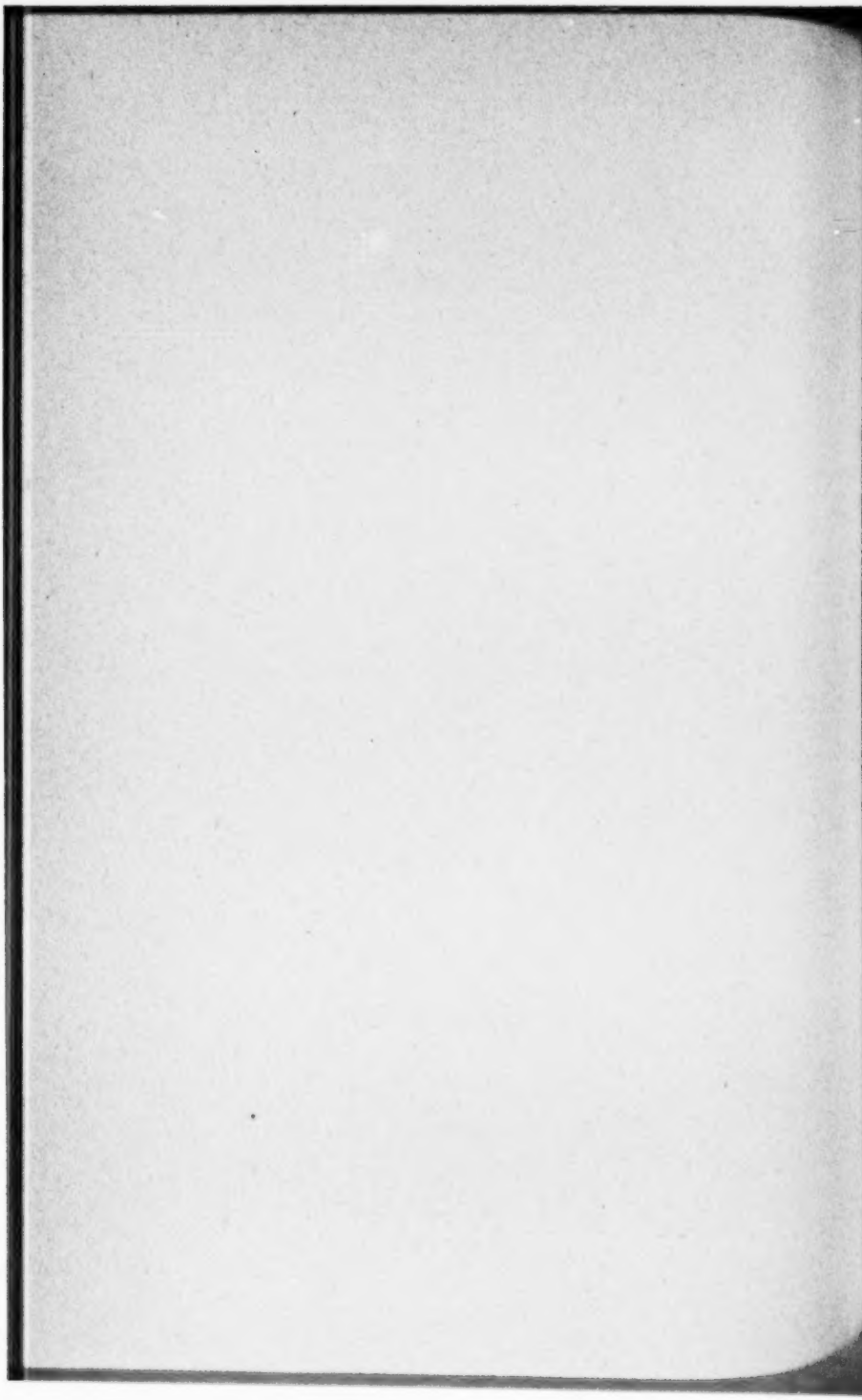

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GLOSSARY.

Ageco—Associated Gas and Electric Company, Debtor.

Agecorp—Associated Gas and Electric Corporation, Debtor.

CCs—Convertible Certificates without fixed maturities.

CDCs—Convertible Debenture Certificates and Convertible Debenture Obligations without fixed maturities.

CICs—5½% Convertible Investment Certificates, due November 15, 1938.

COABs—Convertible Obligations, Series A and B, due 2002.

Elias Committee—Appellants Irving Elias, Max Menachen and Michael Moise, constituting the Protective Committee for the Holders of Convertible Obligations Due 2002, All Series (Exclusive of Those Holders Who Acquired Same by Direct Exchange for Original Convertible Debenture Certificates or Convertible Debenture Obligations, Series F) of Associated Gas and Electric Company.

IB and NIB Scrip—Interest Bearing and Non-Interest Bearing Scrip.

Jones Committee—Appellants Thatcher C. Jones, Frederick T. Sutton and Russell M. Van Kirk, constituting the Scrip Holders Protective Committee of Associated Gas and Electric Company.

Old COs—Convertible Obligations without fixed maturities.

Original Holders of COABs—Holders of COABs who obtained such securities in exchange for CDCs and still retain those securities.

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THATCHER C. JONES, FREDERICK T. SUTTON and RUSSELL M. VAN KIRK, constituting the Scrip Holders Protective Committee of ASSOCIATED GAS AND ELECTRIC COMPANY,

Petitioners and Appellants Below.

AGAINST

STANLEY CLARKE, Trustee of ASSOCIATED GAS AND ELECTRIC COMPANY, Debtor, et al.,

Respondents and Appellees Below.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

TO THE HONORABLE, THE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The petition of Thatcher C. Jones, Frederick T. Sutton and Russell M. Van Kirk, constituting the Scrip Holders

Protective Committee of Associated Gas and Electric Company, respectfully shows:

Summary Statement of the Matter Involved.*

Petitioners seek a review of the final determination of the United States Circuit Court of Appeals for the Second Circuit, which affirmed an order of the United States District Court for the Southern District of New York, entered on August 13, 1943, in proceedings under Chapter X of the Bankruptcy Act, for the reorganization of the Debtor, Associated Gas and Electric Company (AGECO).** Petitioners constitute a Protective Committee for the Holders of Associated Gas and Electric Interest Bearing and Non Interest Bearing Scrip.

The order appealed from classified the holders of convertible obligations due 2002, all series (except original holders of COABs, who exchanged them for CDCs) and scrip as subordinate to general creditors other than holders of obligations convertible at AGECO's option into stock (897-898, 900).***

On November 26, 1941, the District Court entered a bar order requiring that proofs of claims against the Debtor, with certain exceptions not here material, should be filed on or before February 28, 1942, (3). Many proofs of claim were filed (4).

Among the claims filed were those of convertible obligation holders and scrip holders, each separately represented by appellants-petitioners' committees.

Under date of March 24, 1942, the AGECO Trustee petitioned for an order determining the validity of some

*For the convenience of the Court, the Summary Statement of the matter involved is in all respects similar to that contained in the petition of the Ageco COAB Committee, except for special references pertaining to the particular securities.

**A glossary of the abbreviations used herein precedes the petition.

***References are to folio numbers unless otherwise noted.

of those claims and dividing the claims into classes according to their nature (4). Objection to the types of claims enumerated in the Trustee's petition were thereafter filed by the Trustee and by various other parties (31-255).

On October 27, 1942, the District Court referred these claims and objections to Honorable Frederick E. Crane, as Special Master, "to hear the evidence on the issues raised by said claims and objections and to report his findings of fact and conclusions of law as to the validity, priorities and proper division into classes of said claims" (256-289). The Special Master held hearings at which evidence was taken (5) and, on March 31, 1943, filed his report, including his findings of fact and conclusions of law (586-789). The Special Master recommended, among others, that the COAB and Scrip claims should be classified as subordinate to general creditors.

The report thereupon came on for confirmation before the District Court and objections thereto were duly filed (6; 790-809).

Apart from certain claims which are not material to this petition, the relevant claims treated in the Special Master's report fall into five types:

1. Holders of Convertible Debenture Certificates and Convertible Debenture Obligations without fixed maturities (CDCs).
2. Holders of Convertible Certificates (CCs) and Old Convertible Obligations (Old COs) without fixed maturities.
3. Holders of Convertible Obligations, Series A and B Due 2002 (COABs), or Preferred or Preference Stocks, who obtained their COABs or stock in exchange for CDCs, and who still hold the

COABs or stock thus obtained (Original Holders of COABs).*

4. Other Holders of COABs or Preferred or Preference Stocks.

5. Holders of Interest Bearing and Non-Interest Bearing Scrip (IB and NIB Scrip).

At a hearing held on April 14, 1943, the Trustee of AGECO moved that the District Court pass only on certain parts of the Special Master's report, findings of fact and conclusions of law. It appeared in the District Court that a Plan of Compromise and a Plan of Reorganization had been proposed by the AGECO Trustee and AGECORP Trustees and that these Plans made some provisions for Types 1 and 3 (833-839). The order of the District Court dated August 13, 1943, only reviewed conclusions of law 5 and 6 of the Special Master's Report, and the findings of fact relating to those conclusions, and classified the types of claims represented by the petitioners-appellants as subordinate to general creditors of AGECO pursuant to the Bankruptcy Act, Sec. 197 (862; 892-904). The order confirmed certain parts of the Special Master's report but deferred consideration of those types of claims (Types 1 and 3) for which some provision had been made in the Plan of Compromise and Plan of Reorganization, and reserved jurisdiction to pass on the portions of the Special Master's Report relating to them (840-904).

No provision was made for Types 2, 4 and 5, in the proposed Plan of Compromise or the proposed Plan of Reorganization. The Debtor's financial condition is such that subordinate creditors will not participate in any Plan of Reorganization and they accordingly have been

*We do not include in the phrase "Original Holders of COABs", persons who acquired their COABs otherwise than on an exchange of CDCs, even if they acquired their COABs directly from AGECO.

given no recognition in a plan recently proposed by the Trustee of AGECO and the Trustees of AGECORP (838-840), which Plan of Compromise and Plan of Reorganization were approved by an order of the District Court dated September 12, 1944, pursuant to Section 144 of the Bankruptcy Act.

Inasmuch as no provision was made for Types 2, 4 and 5 in the Plan of Compromise or Plan of Reorganization, any decision with respect to the fairness of these plans is necessarily dependent, therefore, upon a proper judicial determination that the claimants represented by petitioners are subordinate creditors. The District Court recognized that it was not possible to determine *favorably* the rights of these claimants without an adjudication of the status of the CDCs and the original holders of COABs but the District Court believed that *adverse* determinations could be made on uncontested findings of fact of the Special Master without consideration of the entire record and without adjudicating the status of the CDCs and original holders of COABs. Accordingly, the District Court proceeded to a determination of the claimants of Types 2, 4 and 5, held that they were subordinate to general creditors, and entered an order so classifying them (839-862; 892-904). The District Court did not consider the remaining findings and conclusions of the Special Master but *assumed* that the issues therein involved would be resolved in favor of appellants (843). The District Court passed only upon those findings of fact and conclusions of law of the Special Master that were relevant to this classification and adopted them with minor modifications (897-903). The findings of fact thus adopted by the District Court are set forth in Appendix C to the opinion of the District Court (874-891).

The effect of the order appealed from is to exclude from participation in the limited funds of the debtor, all holders of Scrip, with the exception hereinafter discussed of Scrip in the hands of Original Holders.

The COABs were in effect divided by the order appealed from into two different classes: Class 1 consisted of Holders of COABs due 2002, Series A and B, which had been issued in exchange for CDCs and which remain in the hands of the persons to whom they were originally issued or their personal representatives. This class participates in the limited funds of the Debtor by participation in the Plans of Compromise and Reorganization. Class 2 consisted of Holders of Convertible Obligations Due 2002, Series A and B, which were in the hands of persons other than the original holders of CDCs who had exchanged them for COABs. This class includes transferees of persons who had originally held CDCs or persons who had exchanged them for CCs, old COs or for cash. This class does not participate in the limited funds of the Debtor and has been excluded by the Court order appealed from.

The scrip, however, was not divided into classes, although part of the outstanding scrip was issued to persons in each of the above two classes. Thus scrip owned by Original Holders of COABs (Class 1) was held subordinate to general creditors and treated in the identical manner as scrip in the hands of transferees (Class 2). The Circuit Court of Appeals in the last paragraph of its opinion observed that "this seems doubtful on the court's own theory" (p. 336).

The petitioners-appellants represent all holders of scrip which were described hereinbefore as Type 5.

All of the Scrip was issued in payment of interest on the COABs (340-342). Most of the COABs were issued by the Debtor in exchange for CDCs (751). On May 31, 1932, there were outstanding in the hands of the public, CDCs in the amount of $36,333,539 (306). On January 10, 1940, there were CDCs outstanding which had not been surrendered in the sum of $3,808,527 (333-334). The CDCs, CCs and old COs were all by their terms con-

vertible at the *company's option* except under certain conditions, into specified classes of its preferred or preference stocks.

The CDCs, CCs and old COs were all purportedly debt securities of AGECO. The CCs and old COs, however, contained subordination clauses substantially like the one that is in the COABs and the IB and NIB scrip (874). The essential difference between the CDCs and the COABs is that the COABs as well as the CCs and old COs contain a subordination clause whereas the CDCs do not. The subordination clause in the scrip certificates (554-555) provides in part as follows:

> "It is the intent hereof that this Certificate shall be subordinate to the following (hereinafter called 'Senior Obligations'), namely: all indebtedness of the Company, now or hereafter issued and outstanding, except (1) the 5%, 5½%, 6½%, and 7% Convertible Obligations, Series A and 6% Convertible Obligations, Series A and B, of the Company and (2) indebtedness or obligations convertible at the option of the Company into stock of the Company of any class or subordinated by their terms to other indebtedness or obligations of the Company;"

The subordination clause in the COABs is substantially the same (880-881; 554-555).

The District Court held, in approving the Plan of Reorganization and Plan of Compromise of AGECO that FIOs (Fixed Interest Obligations) unconditionally payable as to both principal and interest on specified dates issued pursuant to indentures with Corporate Trustees, was general unsubordinated debt of AGECO. The District Court likewise held that CICs (Convertible Investment Certificates) unconditionally payable as to both principal and interest on specified dates, was likewise senior

or general unsubordinated debt of AGECO. The CICs, however, by their terms were convertible at the *option of the company* into preferred stock of the company.

The CDCs by their terms were not subordinate to other obligations of AGECO (703). The CDCs by their terms become due on the happening of certain specified events, to wit:

"(a) Default in the payment of interest;

(b) Adjudication of AGECO as insolvent and permanent Receivers appointed for its property;

(c) Becoming bankrupt and voluntary or involuntary petitions being filed;

(d) Upon the transfer of all or substantially all of its assets unless the acquiring company assumed the obligations of AGECO under the CDCs (fols. 690-2)."

Prior to 1931 AGECO experienced certain financial difficulties. In 1931 and 1932 AGECO became further involved in financial difficulties and the notorious Mr. Hobson began his financial manipulations, which resulted in his eventual conviction and imprisonment. On April 19, 1932, the COABs were issued pursuant to authority contained in resolutions adopted by the Board of Directors of AGECO (875).

In May of 1932, AGECO first notified holders of CDCs, CCs and old COs that AGECO was exercising its option to convert those securities into stock; at the same time AGECO offered the security holders an option to take the then newly authorized COABs in place of the stock into which they were purportedly being converted. Some security holders held on to their CDCs, CCs and old COs; some exchanged them for stock; the others, the vast majority, took COABs (876). It is estimated that the

bulk of the CDCs in the approximate amount of $30,000,000 or more, were exchanged for COABs (751).

In 1936 and 1937 AGECO paid interest, in the form of IB and NIB scrip, to all holders of COABs, however issued or acquired.

Both the COABs and Scrip were assignable, and many of them were sold or transferred by their original holders (884; 890). Some Scrip remained in the hands of original holders.

The principal amount of Scrip outstanding on January 10, 1940, when the Debtor was adjudicated a bankrupt was $10,199,780.83.

The basic contention was made in this litigation before the District Court that AGECO's conversion privileges with respect to the CDCs, CCs and old COs were invalid and that, even if valid, the options to convert were improperly exercised.

The District Court did not rule on these contentions but asssumed in favor of appellants that the exchanges of CDCs for COABs were invalid and that original holders of COABs have a right to rescind the transactions (843).

The Court, nevertheless, ruled that all persons who hold IB or NIB scrip have no right to complain of the assumed invalidity of the CDC exchanges (852-853).

The Special Master found in his Report that CDCs 1931 Series, which were valid and outstanding, were *unsubordinated general debt* of AGECO and entitled to participate as such in the funds of AGECO (788). The Special Master also found that scrip by its terms *was not subordinate to CDCs* of any issue which was valid and outstanding (676).

The District Court however held that the subordination provisions in the COABs and scrip were valid and enforceable in bankruptcy (854-857). Accordingly an order was entered classifying the claims of all COABs (except original holders of COABs) and scrip, as subordinate to

general creditors other than the holders of obligations convertible at AGECO's option into stock (897-898; 900). This is the order which was affirmed by the Circuit Court of Appeals and which petitioners-appellants now seek to review.

This Court Has Jurisdiction.

The jurisdiction of this Court is invoked under subdivision (c) of Section 24 of the Bankruptcy Act, as enacted June 22, 1938.

The date of the entry of the order, judgment and decree of the Circuit Court of Appeals, sought to be reviewed, is July 14, 1944 (R., p. 337). This petition, presented within three months after the entry of the aforesaid order, is timely.

The opinion of the United States Circuit Court of Appeals for the Second Circuit is reported at 143 F. (2d) 640. The opinion is also printed in full in the Record (R., pp. 324-337). The opinion of the United States District Court for the Southern District of New York is reported at 53 F. Supp. 107. The opinion is also printed in full in the Record (R., pp. 271-297).

The Circuit Court of Appeals has in this case decided important questions of general law in a way probably untenable and against the weight of authority, and important questions of federal law which have not been, but should be, settled by this Court (Supreme Court Rule 38 [5] [b]).

As stated by the United States Circuit Court,

> "the issue involves peculiarly interesting questions of priority and subordination of corporate bonds in that the District Court has made a distinction between original holders and transferees of certain bonds and has subordinated the claims of transferees to an extent which it has not been prepared

to go with respect to the claims made by original holders of the same bonds" (R., p. 325).

The decision of the Circuit Court of Appeals as to the validity and enforceability of subordination agreements in bankruptcy and its interpretation of Section 65-a of the Bankruptcy Act, particularly where the subordination agreements in question have been obtained without consideration, and through fraud and misrepresentation, is probably untenable and against the weight of authority, and involves an important question of federal law which has not been but should be settled by this Court (Supreme Court Rule 38 [5] [b]).

The decision of the Circuit Court of Appeals as to the legality of an option of a corporation to convert its bonds into stock, is probably untenable and against the weight of authority and involves an important question of general law (Supreme Court Rule 38 [5] [b]).

The decision of the Circuit Court of Appeals as to the legality of an option of a corporation to convert its bonds into preferred stock upon the fulfilment of certain conditions precedent and the question of whether such conditions were properly fulfilled prior to the exercise of said option, was improper, erroneous and departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision where the District Court assumed that the issues involved would be decided in favor of appellants (843) and the respondents likewise assumed that the issue involved would be resolved in favor of appellants (Supreme Court Rule 38 [5] [b]).

The decision of the Circuit Court of Appeals erroneously sustained the procedure and order of the District Court which confirmed only certain conclusions of law and findings of fact pertaining to appellants' substantive

rights without disposing of other issues of fact and law equally necessary for the full adjudication of the rights and status of the appellants herein. The procedure of the District Court sanctioned by the Circuit Court of Appeals was erroneous and prejudicial to the rights of the appellants where the report of the Special Master was rendered on all the issues and the issues herein were indivisible. This unusual and novel procedure accounts for the necessary assumptions made by the District Court in appellants' favor of the undetermined findings of fact and conclusions of law. The Circuit Court of Appeals recognized the unfairness of this mode of procedure (R., p. 331) and attempted to remedy it by erroneously ruling on all the issues, even those not determined by the District Court (R., pp. 332-334). The Circuit Court of Appeals thus sanctioned the departure by the District Court from the accepted and usual course of judicial proceedings so as to call for an exercise of this Court's power of supervision (Supreme Court Rule 38 [5] [b]).

Questions Presented.

The questions presented herein involve important questions of both procedural and substantive law. It is contended that the procedure adopted by the District Court as well as the Circuit Court of Appeals exceeded their jurisdiction and departed substantially from the accepted and usual course of judicial proceedings. The substantive issue, as stated by the Circuit Court of Appeals, "• • • involves peculiarly interesting questions of priority and subordination of corporate bonds • • •". The following questions must be considered by this Court:

1. Assuming that creditors (holders of Scrip) were induced by their debtor through fraud or mistake to

agree to subordinate their debt to other creditors, without any additional consideration therefor, is the agreement to subordinate contained in these securities enforceable in a court of bankruptcy or equity?

2. Is a provision in a bond issued by a corporation, whereby the corporation at its option may convert the bond into stock, legal?

3. Is it against public policy for a corporation to issue a bond convertible at the option of the corporation into stock of the corporation?

4. Did the Circuit Court of Appeals err and exceed its jurisdiction in determining issues assumed by the District Court to have been decided in favor of appellants?

5. Was the procedure adopted by the District Court, and sanctioned by the Circuit Court of Appeals, of determining certain, but not all, of the issues pertaining to the Scrip correct and proper or prejudicial to the rights of appellants herein?

6. Is the Scrip by its terms subordinate to any issue of CDCs or 5½% CICs?

7. If the Scrip is not subordinate to CDCs or CICs of any issue, which are valid and outstanding, is the Scrip entitled to stand and share on a parity in the funds and reorganization of the debtor with the CDCs and CICs who participate and share as general creditors of AGECO.

8. Do the subordination provisions and terms of the Scrip make the Scrip an "illusory promise" so as to give their holders a cause of action against AGECO as general creditors?

Reasons Relied on for Allowance of the Writ.

1. The question of the power of a corporation to issue a bond convertible at the option of the corporation into stock has never been raised in any case other than the instant case, and has never been passed upon by any court, with the exception of the court below.

2. The Circuit Court erred by approving the procedure of the District Court. The District Court exceeded its jurisdiction by passing upon only certain issues pertaining to the COABs and by assuming the other issues in the case to be in their favor. It was impossible to fully determine in their favor the rights of these claimants without an adjudication of all the issues presented, although this would incidentally involve an adjudication of the status of the CDCs and the original holders of COABs who were participating in the Plan of Compromise and Reorganization. The District Court's opinion that adverse determinations could be made against appellants on certain issues without consideration of the entire record and all the issues, prejudices the rights of the appellants who were entitled to have all the substantive issues determined on their merits in one appeal. The procedure of the District Court sanctioned by the Circuit Court of Appeals in effect splits one appeal into several. It must be recognized that the effect of this ruling may be that after argument of this case on the limited issues presented before this Court, if the contentions urged by the appellants are upheld, it will then first become necessary to go back to the District Court for a determination of the other issues and further appeals may then be taken to the Circuit Court of Appeals and thereafter possibly to this Court. This procedure is unquestionably prejudicial to the rights of appellants and only results in a multiplicity of legal proceedings.

3. The substantive questions involved have a public aspect and are of genuine intrinsic public importance which call for their most authoritative determination. The questions involved concern the administration by a federal court of the estate of an insolvent quasi-public company and its reorganization. The liquidation or reorganization of such large holding companies both by the federal courts and by the Securities and Exchange Commission, a quasi-judicial and administrative branch of our government, has become increasingly frequent and it may reasonably be assumed from past experience that such reorganizations will occur in the near future. It is essential in the public interest that the questions here presented be reviewed and finally be settled.

4. The questions as to the validity and enforceability of subordination agreements in bankruptcy under Section 65A of the Bankruptcy Act, particularly where the subordination agreements in question, as assumed by the record below, were obtained without consideration and through fraud and misrepresentation, has never been adjudicated by this Court, so far as our research indicates, and involves an important question of federal law which has not been but should be settled by this Court.

5. The interests at stake and the number of persons affected are very substantial. Involved herein is the elimination, in the distribution of an estate, of claims of over $10,000,000 in principal amount. Involved are the rights of over 36,000 general creditors spread throughout our land who rightfully look to the courts for a fair and equitable administration and distribution of this insolvent estate. Nor is this merely a controversy between private interests in the usual sense, since the questions involved concern hundreds of thousands of investors who daily trade in these securities and others of similar char-

acter. It follows that the acts of the Federal courts and administrative branches of the Federal Government who have the duty to supervise the liquidation or reorganization of such quasi-public corporations, shall not violate the United States Constitution and that the petitioners and those similarly situated shall be accorded every protection which the Constitution affords.

6. The public interest and administration of justice will be subserved by this Court's review and by the correction of the patent discrimination and injustice which petitioners believe to inhere in this proceeding.

WHEREFORE, your petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Second Circuit, commanding that Court to certify and send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings of the case, and that the said decree of the United States Circuit Court of Appeals, for the Second Circuit, may be reversed by this Honorable Court, and that your petitioners may have such other, further and different relief in the premises as to this Honorable Court may seem just and proper, and your petitioners will ever pray.

Dated, New York, October 11, 1944.

Respectfully submitted,

THATCHER C. JONES,
Chairman of Scrip Holders
Protective Committee, Petitioners.

LOUIS BOEHM,
BERNARD D. FISCHMAN,
Of Counsel.